

1978 Annual Report to the Shareholders

The Cover

From bringing families closer together, to providing emergency service; from private switchboards, to million-dollar switching centres; from business long distance calls, to data communications between computer terminals in remote parts of the country, Island Tel provides a wide variety of services to its customers. These services were used more in 1978 than in any previous year in the Company's history. Thus, the theme for the annual report in this record year is "Services in Use".

Acknowledgements

Island Tel wishes to extend sincere thanks to the following employees and customers who appear in the photographs in this Annual Report:

James Allison
Donald Baker
Wayne Barrett
Jean Collicutt
Eileen Hickox
Karen Johnston
Sandra Livingstone
Ann Marie McDonald
Don MacEwen
Lou Pantry
Marilyn Peters
Christina Rodd
Joan Stephens

Annual Meeting

The annual general meeting of the shareholders of The Island Telephone Company Limited will be held at the Head Office of the Company, 71 Belvedere Avenue, Charlottetown, P.E.I.
Friday, May 4, 1979 at 11:30 A.M.

From the President

During 1978, the use of Company services reached an all time high. The addition of 4,140 telephones to the system was the largest annual increase in the Company's history, and the growth rate in telephones (7.5 percent) was one of the highest of any telephone company in Canada. Long distance calling also continued to grow at a strong pace during the year.

It is noteworthy that your Company succeeded in satisfying the strong demand for additional services while continuing to improve services. During 1978, Extended Area Service (eliminating long distance charges) was provided between four pairs of

exchanges and in July, the Charlottetown Base Rate Area (no monthly mileage charge for one-party service) was extended to include the surrounding communities of West Royalty, Winsloe and Milton. Emphasis also continued on the program to reduce the number of subscribers on multi-party lines.

Much of the success in 1978 was attributable to the dedicated efforts of the employees — many of whom are also shareholders. The dual challenge of expanding and improving the system requires strong effort by employees, particularly in this period of rapid growth.

The Company must continue to make capital expenditures for the additional telephones, cables, switching equipment and other facilities necessary for expanded and improved service. A total of \$7.5 million was spent on capital construction in 1978 — down from the high of \$8.9 million in 1977. These expenditures were financed from internal sources and from an issue of first mortgage bonds in the fourth quarter of 1978.

The Senior Management Team

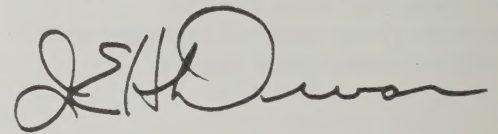
Left to right are: W.C. Auld, Executive Vice-President; I.E.H. Duvar, Chairman of the Board and President; E.J. Hicks, Vice-President, Finance; and D.R. Livingstone, General Manager.



Earnings per average common share increased in 1978 by 16¢ to \$1.90 a share. Similarly, the rate of return on average invested capital increased to 10.9 percent and the return on average common equity to 14.5 percent. Much of the improvement in earnings results from the greater use of local and long distance services during the year. The Company requires satisfactory earnings to support additional capital investment for expansion and improvement of the system and to continue the provision of effective and efficient services to customers.

This Annual Report of the Directors summarizes the Company's 1978 achievements in providing useful communications services to customers. It also features a few of the many uses of the Company's communications services, from basic telephone service to specialized services such as data communications, business services and mobile radio.

Nineteen-seventy-nine appears to be another year of substantial growth in telephone service. We anticipate further increases in local and long distance usage as well as continued strong growth in other telecommunication services.



I. E. H. Duvar

Chairman of the Board
& President

Charlottetown, P.E.I.
March 15, 1979

Telephones in the Home

Island Tel provides residential telephones in a wide variety of styles and colors to suit every customer's needs. During 1978, Touch Tone service was made available across

Prince Edward Island and customers responded rapidly to the sleek styling, speed and ease of Touch Tone Calling.



Directors' Report

Growth in Services

More new telephones were installed in Prince Edward Island during 1978 than in any previous year. In addition to the growth of telephones in service, the Company also experienced a strong customer demand for most other services offered. This placed a heavy workload on staff members, but nevertheless, planned programs to expand the system and provide service improvements were successfully completed during the year.

The net increase of 4,140 telephones in service during 1978 exceeded our expectations. At year end, there were 59,436 telephones in service — up 7.5 percent over 1977. The rate of increase was among the highest experienced by all Canadian telephone companies during 1978.

Telephone service is growing substantially more quickly than the population in Prince Edward Island. In 1974, there were 40.2 telephones in service for every 100 people. By 1978, this figure had grown to 48.6 telephones in service.

Thousands of long distance calls have been eliminated in recent years due to the introduction of toll free calling between many neighboring exchanges throughout the province. In spite of this Extended Area Service, there was a 5.3 percent increase in the number of long distance calls placed in 1978 over 1977, and an 18.7 percent increase in the revenue received from these calls.

Direct Distance Dialing from all corners of the province became a reality in 1977, and it has met with rapid customer acceptance. In 1978, 84 percent of all long distance calls were directly dialed by the customer. This compares favorably to 72 percent in 1977 and 59 percent in 1976.

Mobile services, including mobile telephone, mobile radio and radio paging proved very popular during 1978. There was an increase of 18.5 percent in the number of mobile telephones in service during 1978, and the number of calls to and from these telephones grew by 31 percent. Late in the year, this service was expanded to West Prince when a new transmitter was opened at O'Leary. In combination with facilities in Summerside, Charlottetown and Murray River, these new facilities complete the province-wide mobile telephone network. Paging service also increased during 1978, as the number of units in service grew by 23 percent to 243 units.

Through aggressive marketing, the Company continues to effectively serve the highly competitive market for private mobile radio service. By year end, there were 748 units in service over 79 systems, including taxi and delivery fleets, emergency vehicles, and farm equipment.

Not only does the Company offer standard units for mobile communications, but it also demonstrated a high degree of sophistication in the design of tailor-made communication systems for specific functions. In 1978 for example, the Special Services group designed an integrated telephone system for the Kensington Police Department which featured specially-designed telephones for the squad car, hand-held telephone sets for patrol use, a special system for the police office and, in addition, a link up of this system to the officers' home telephones.

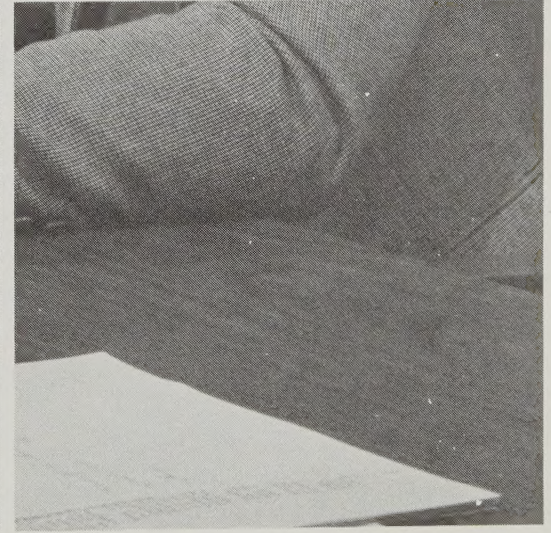
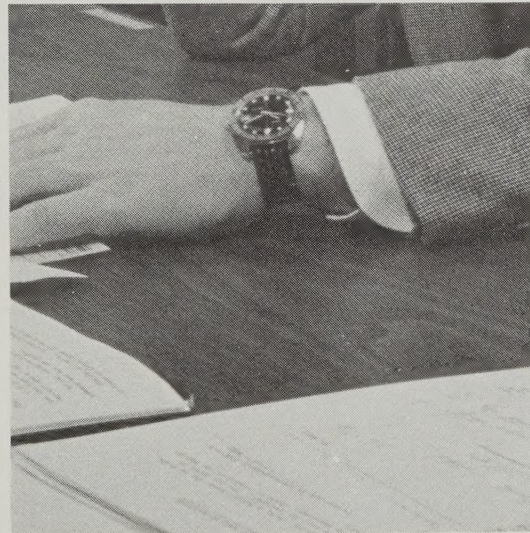
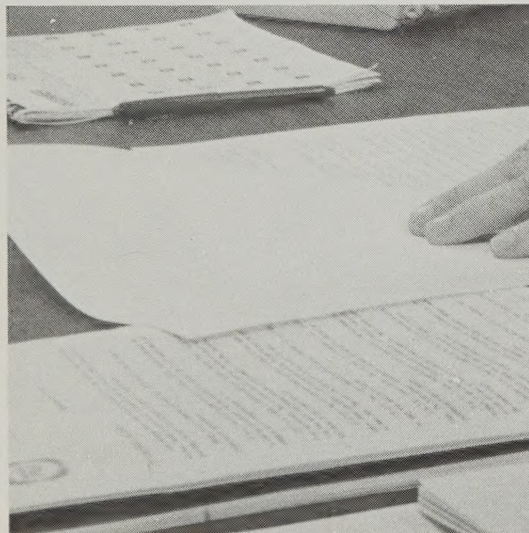
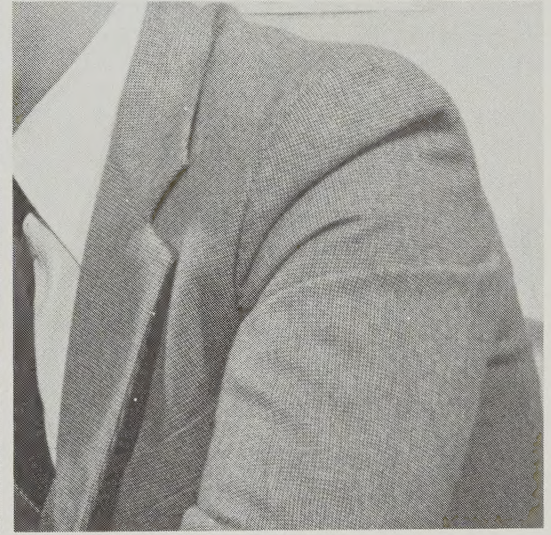
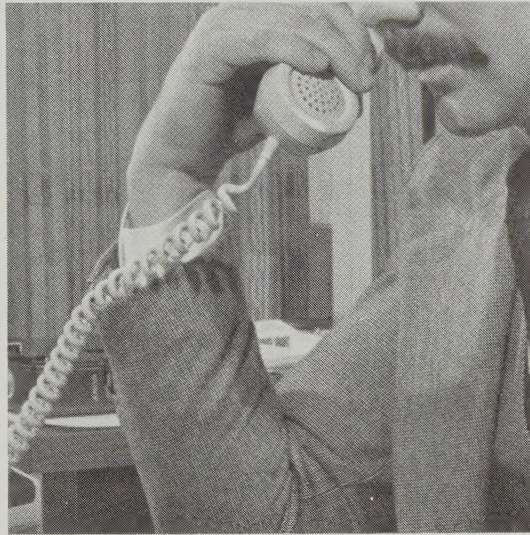
As a member of the Computer Communications Group of the TransCanada Telephone System, the Company is an integral link in the national Dataroute and Dat-O-Net networks. At year end, the Company had increased the number of units in service across the province by 14 percent over 1977.

The provincial elections held in 1978 in Prince Edward Island resulted for Island Tel in the largest computer communications sale ever made in Eastern Canada until that time. Facilities installed for the April 24th election included Dataroute circuits on Vucom 3 CRT's provided to the CBC for computerized election results via the CBC - Ottawa computer, as well as voice and data services for other media, the Chief Electoral Officer, CN/CP and others.

Business Communications

Telephone communications are invaluable in the administration of any type of business. Whether business people choose the conventional telephone, the versatile Logic 10 set (shown below), or a more

sophisticated telephone switchboard (insert), they may be assured of finding telephone services to match the needs of their businesses.



More than ever, customers want to use premium telephone units. By year end, the number of residence extensions in service had increased by 17 percent to 9,726, the number of color telephones had grown to 15,070 (up 5 percent), and Contemptra telephones had increased by 13.2 percent to 3,130.

But the most successful premium telephone feature in 1978 was Touch Tone. Although Touch Tone service was not available outside the Charlottetown Exchange until November, there was a total of 3,263 Touch Tone telephones in service across Prince Edward Island at year end. This was an increase of 195 percent over 1977. Five and one-half percent of total telephones are now Touch Tone.

Improved Services

While responding to the demand for new service, Island Tel has remained committed to a wide-ranging service improvement program, which continued on schedule in 1978.

Four Extended Area Service routes providing toll-free calling to a neighboring exchange were completed during the year. Extended Area Service was provided between Eldon and Vernon River, Eldon and Charlottetown, Tyne Valley and Summerside, and New London and Summerside. By year end, 98.7 percent of all Company customers had toll-free calling to a neighboring exchange.

During the year, the Company stepped up its program to substantially reduce the number of customers sharing each multi-party line in rural areas. The average number of customers sharing each multi-party line, which stood at 4.8 in 1976 and 4.2 in 1977, was reduced to 3.7 in 1978 at a total cost of \$652,000. This program will be continued as an important service improvement priority in 1979, when the average number of customers per multi-party line will be further reduced to 3.2.

Private line service was offered in 1978 to all rural business customers. This is a two-year program which will be completed in 1979.

Interruptions in the telephone system are being reduced as a result of the Company's program of burying telephone cables and wire whenever possible. In 1978 a total of 270 miles of cable and 118 miles of wire were buried, not only improving the Company's service but also helping to retain the natural beauty of Prince Edward Island.

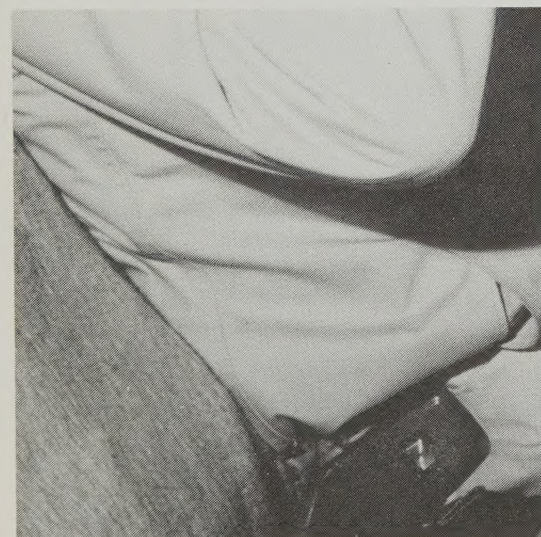
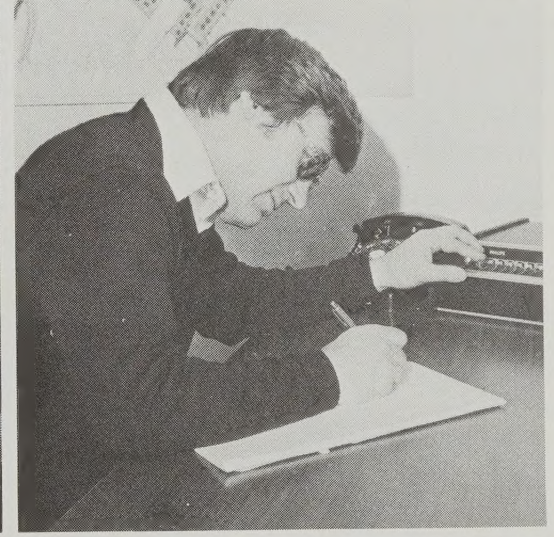
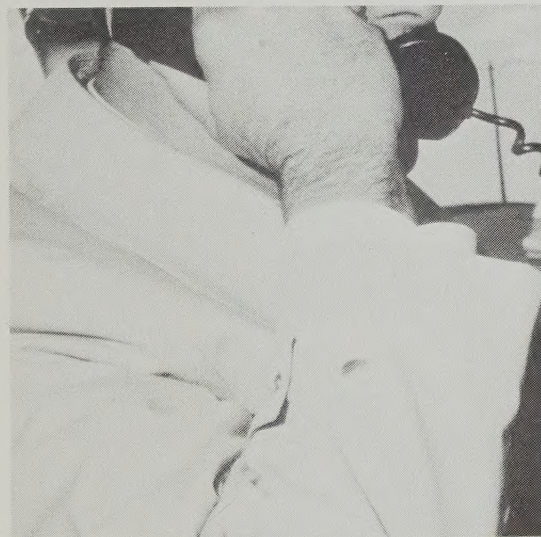
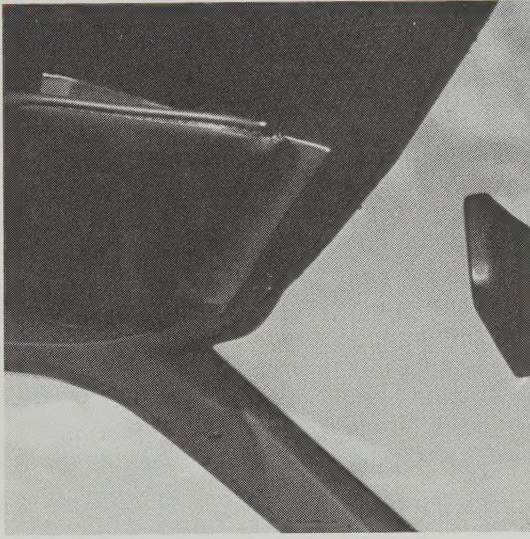
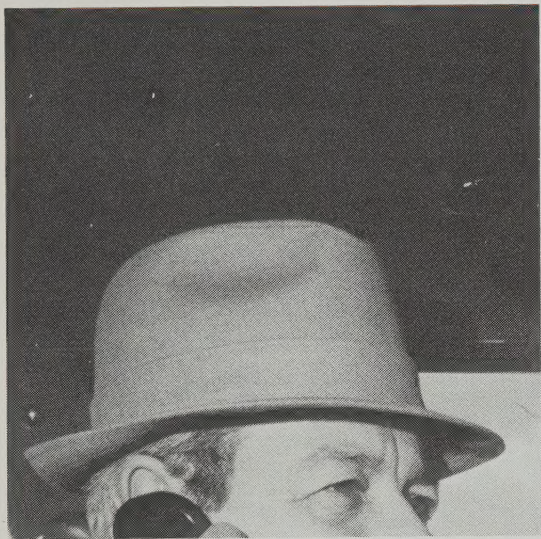
The Base Rate Area in the Charlottetown Exchange was enlarged during the year to include the areas of West Royalty, Winsloe and part of Milton. The Company also completed a Base Rate Extension during 1978 to include Ferry Road in the New Haven exchange. Monthly mileage charges on one and four-party exchange service were eliminated for subscribers in the expanded Base Rate Areas, and customers adjacent to these new boundaries had reduced mileage charges for these services.

In September 1978, the Company eliminated the three minute minimum charge which had applied on long distance calls within the province. A direct dialed one minute long distance call now costs one-third of the former three-minute minimum rate.

Technology simplifies communications

The growth of telephone technology has paralleled the increasingly sophisticated needs of business. Not only does technology permit the near-instantaneous transmittal of data (upper inset), but it also frees

business people through the use of such facilities as the mobile telephone (below) and automatic telephone answering systems (lower inset). These special services are an area of rapid growth for the company.



Expansion of the Network

One cornerstone of network growth in 1978 was the installation of a new computerized switching center in the Montague Exchange. Completed in December 1978, this new facility replaces older equipment which had been used to capacity and could not accommodate anticipated future growth in the exchange. The new switching center also provides customers in the Montague exchange with a general upgrading of telephone service including the convenience of automatic number identification on long distance calls for customers with private lines.

During the year, Company employees installed more new telephones (14,505) and removed more (10,240) than ever before for a total of 24,745 "in" and "out" orders.

The Company's total capital budget for 1978 was \$7.47 million. These funds were required to provide more telephone lines to meet present and future growth requirements, continue service improvements, provide Touch Tone availability, and replace worn-out plant and other equipment.

The Company anticipates the high levels of growth experienced in 1978 to continue during 1979. Estimated capital expenditures for 1979 are \$8.8 million. These funds are required to provide sufficient local and long distance calling capacity as well as improved service in a period of rapid expansion of the network.

In order to meet the growth expected in 1979 and future years, as well as provide further service improvements, the Company will spend almost \$800,000 in 1979 to provide additional dial switching equipment to seven exchange offices: Charlottetown, Summerside, Souris, Tignish, New Haven, Vernon River and Hunter River.

The Company also plans to provide for the continued growth in long distance calling by placing additional trunk circuits linking the main switching office in Charlottetown with most exchange offices throughout the Province. Also in 1979, Extended Area Service will be introduced between the exchanges of Morell-St. Peters and Charlottetown.

Corporate Design

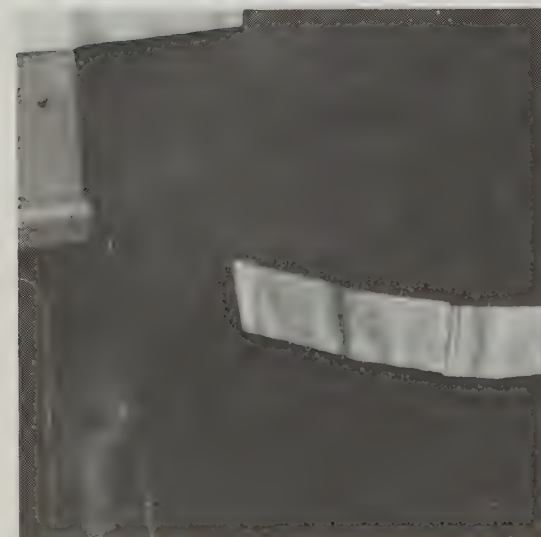
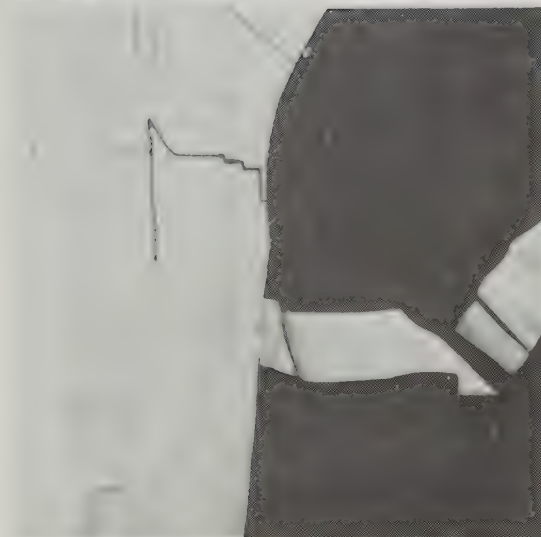
The Company introduced a bright new corporate design during 1978, including a modern company signature incorporating a stylized telephone.

This new look, which will be fully implemented by mid-1979, has already made its appearance on Company vehicles and literature. It has been designed for instant company identification and, in the case of company vehicles, for maximum visibility in traffic.

In an emergency . . .

The telephone has proved itself over and over again to be a lifesaver. Through the use of specially-designed radio communications systems, emergency organizations

such as the North River Fire Department (below) can save many valuable minutes in responding to a crisis.



People

At year end, Island Tel provided employment for 293 people — 166 men and 127 women — compared to 299 one year ago. Their salaries and wages in 1978 totalled \$4,580,000.

In addition, the Company paid \$916,800 or 20 percent of the payroll as follows:

- \$703,300 in payments by the Company to the non-contributory pension plan;
- \$104,500 in payments for sickness, accident, group insurance and supplementary hospital insurance;
- \$50,800 in payments to the Canada Pension Plan;
- \$58,200 in payments for Unemployment Insurance.

The Company's strong commitment to training employees continued during 1978. Throughout the year, 105 craft, traffic operators and management people attended special Company training courses inside and outside the Province.

Safety

Both the Company and the staff pay considerable attention to on-the-job safety. As a result, in 1978 Island Tel experienced one of the lowest lost-days safety rates in Prince Edward Island. Monthly safety meetings are held in every department throughout the Company, and a main committee meets to discuss safety issues regularly. In November, a training course on the revised Accident Prevention Plan was held for 35 management staff over a period of three days. This program is being implemented throughout the Company on a continuing basis.

Organizational Changes

Nineteen-seventy-eight marked the first assignment of an Island Tel staff member to the TransCanada Telephone System (TCTS) in Ottawa. Robert E. White, Trunks and Switching Foreman in Charlottetown, accepted a two-year assignment with TCTS in Ottawa to work on TransCanada switching operations. Other Island Tel staff will be loaned to TCTS in future years.

Summing Up

More customers used more telephone services than ever before in 1978. This rapid growth in service placed great demands on Island Tel and the Company responded by not only keeping up with the workload but also improving the quality of service throughout the network.

It takes careful planning to provide the facilities and equipment to meet present and future customer requirements. Large capital expenditures are required to purchase modern, efficient and cost-effective new equipment for expansion of the network as well as maintain the present telephone system at the highest possible standard. And of course, it is necessary to continue the training of our highly-skilled personnel so they can not only operate and maintain this high technology equipment, but also provide personal and professional service to all customers.

The Prince Edward Island telephone system is one of the finest offered anywhere in the world. We are confident that the system will continue to grow and the Company will continue to provide new and improved services to customers in the future.

For the Board of Directors,



I. E. H. Duvar

Chairman of the Board
and President

Charlottetown, P.E.I.
March 15, 1979

It's not so far!

Loved ones may be many miles away, but separation is not so difficult when sharing is just a phone call away. The long distance telephone network serves an important function in our mobile society.



Financial Review

Operating Revenues for the year 1978 were \$16,534,700 compared to \$14,234,200 for 1977. A 7.5 percent increase in telephones in service and a 5.3 percent increase in long distance calling contributed substantially to this strong revenue growth. Total Operating Expenses were \$10,532,500 for the year compared to \$9,199,500 in 1977. Notably, Maintenance Expenses for the ongoing operation and upkeep of the system were \$3,297,700 and Depreciation Expense was \$2,971,400. These changes, along with changes in the Other Income and expense components, resulted in an improvement in earnings over 1977.

Net Income for the year was \$2,304,900 up from \$1,853,800 a year ago. This net income was required to pay the \$483,000 in preference dividends and \$1,073,700 in common dividends to support the equity investment by shareholders which, at year end, amounted to \$19,289,800. The balance of net income of \$748,200 was retained by the Company and re-invested in the business to help pay for the telephones, cables, switches and other equipment necessary for the provision of telephone service.

Earnings per average common share rose from \$1.74 for 1977 to \$1.90 for the current year, an increase of 9.2 percent. The quarterly dividend on common shares was increased to 30 cents from 27 cents effective with the December 15 dividend.

Likewise, the return on average invested capital increased from 10.4 percent to 10.9 percent and the return on average common equity was 14.5 percent, up from 14.1 percent for 1977.

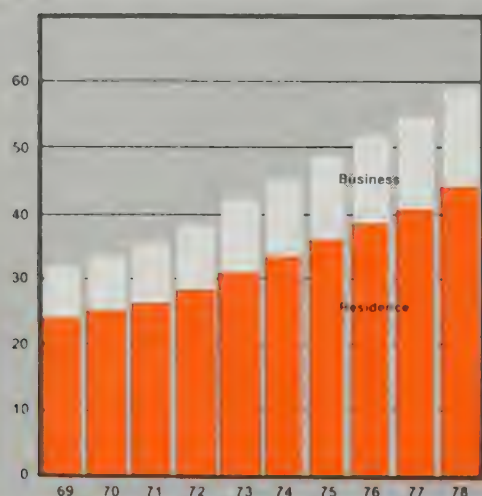
During the year, the capital expenditures for plant and equipment totalled \$7.5 million — down from the record high level of \$8.9 million in 1977. To finance these capital expenditures, the Company obtained funds in the external capital market to supplement funds generated from internal sources. During 1978 the Company issued and sold \$2.5 million of 10 3/8 percent Series M First Mortgage Bonds. These bonds were sold at a discount to yield 10.43 percent to the investor.

Looking to 1979, the Company has planned capital expenditures of \$8.8 million to meet the continuing customer requirements for telecommunication services. It is anticipated that earnings will be satisfactory to support the external financing required to meet these capital expenditures.

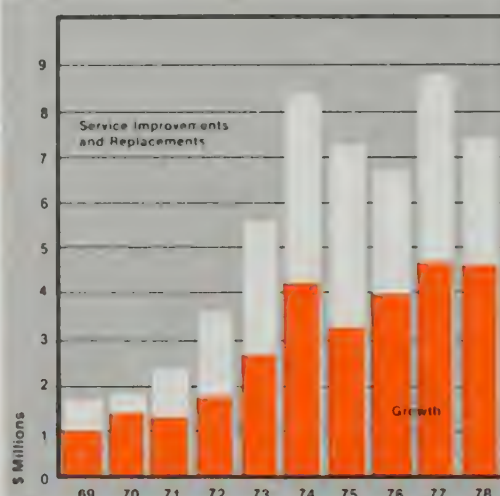
in brief

	1978	1977
Earnings per common share	\$ 1.90	\$ 1.74
Dividends per common share	\$ 1.12	\$ 1.05
Return on average common equity	14.5%	14.1%
Return on average invested capital	10.9%	10.4%
Equity per common share, December 31	\$ 13.45	\$ 12.70
Construction program expenditures (thousands)	\$ 7,470	\$ 8,883
Telephone plant per telephone, December 31	\$ 969	\$ 939
Telephones in service, December 31	59,436	55,296
Long-term debt % total invested capital, December 31	52.8%	50.5%
Employees, December 31	293	299
Salaries and wages (thousands)	\$ 4,580	\$ 4,125
Average common shares	957,609	804,964

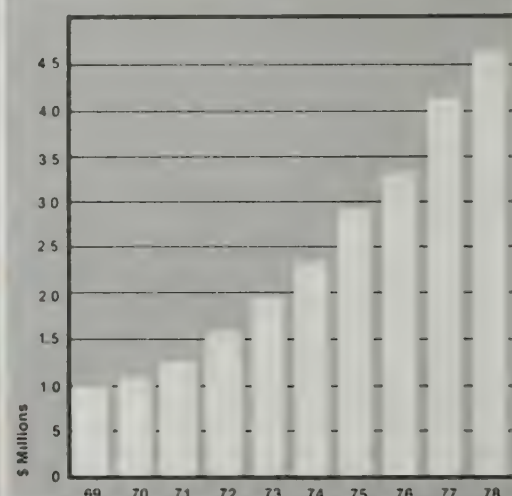
Telephones in Service



Construction Program Expenditures



Salaries and Wages



Auditors' Report

To the Shareholders of
The Island Telephone Company Limited:

We have examined the financial position statement of The Island Telephone Company Limited as at December 31, 1978 and the statements of income, retained earnings and sources of funds used for construction for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the sources of its funds used for construction for the year then ended in accordance with generally accepted accounting principles which, except for the changes in accounting practices explained in note 1 (e) to the financial statements, have been applied on a basis consistent with that of the preceding year.

Clarkson, Gordon & Co.
Chartered Accountants

Halifax, Canada
January 29, 1979

Financial Position Statement

As at December 31

ASSETS

	1978	1977
	\$	\$
TELEPHONE PLANT (Note 1 (b))		
Depreciable telephone plant in service	56,078,200	50,192,100
Other telephone plant (Note 3)	1,153,900	1,304,900
	<u>57,232,100</u>	<u>51,497,000</u>
Less accumulated depreciation	11,199,100	9,682,000
	<u>46,033,000</u>	<u>41,815,000</u>
Materials inventory	353,000	398,700
	<u>46,386,000</u>	<u>42,213,700</u>
INVESTMENTS (Note 4)	<u>111,300</u>	<u>111,300</u>
CURRENT ASSETS		
Cash	261,100	33,200
Accounts receivable	2,132,700	1,847,000
Prepayments	152,400	155,500
	<u>2,546,200</u>	<u>2,035,700</u>
DEFERRED CHARGES		
Unamortized long-term debt expenses	254,200	220,000
Other deferred charges	164,300	102,600
	<u>418,500</u>	<u>322,600</u>
	<u>49,462,000</u>	<u>44,683,300</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

	1978	1977
	\$	\$
SHAREHOLDERS' EQUITY		
Common stock (Note 5)	4,845,700	4,788,000
Premium on common stock (Note 6)	3,922,600	3,852,400
Retained earnings	4,271,500	3,524,700
Total common equity	<u>13,039,800</u>	<u>12,165,100</u>
Preference stock (Note 5)	6,250,000	6,250,000
	<u>19,289,800</u>	<u>18,415,100</u>
LONG-TERM DEBT (Note 7)		
First mortgage bonds	20,250,000	18,250,000
Bank and other notes	1,300,000	500,000
	<u>21,550,000</u>	<u>18,750,000</u>
CURRENT LIABILITIES		
Due to Maritime Telegraph & Telephone Company, Limited	195,100	171,500
Accounts payable	1,237,500	1,166,800
Income taxes accrued	400,300	396,100
Interest accrued	353,200	336,100
Other current liabilities	469,500	415,300
	<u>2,655,600</u>	<u>2,485,800</u>
DEFERRED CREDITS		
Income taxes (Note 1 (c))	5,937,500	4,982,000
Other deferred credits	29,100	50,400
	<u>5,966,600</u>	<u>5,032,400</u>
	<u>49,462,000</u>	<u>44,683,300</u>

The accompanying notes form an integral part of these financial statements

On behalf of the Board:

I. E. H. Duvar
Director

C. J. Fraser
Director

Income Statement

For the Year Ended December 31

	1978	1977
	\$	\$
OPERATING REVENUES		
Local service	7,394,300	6,565,800
Long distance service	8,783,300	7,399,800
Other	428,600	330,800
Uncollectible	71,500	62,200
	<u>16,534,700</u>	<u>14,234,200</u>
OPERATING EXPENSES		
Maintenance	3,297,700	2,801,000
Depreciation (Note 1 (b))	2,971,400	2,752,000
Traffic	931,400	1,151,400
Commercial & marketing	882,100	684,100
Administrative	1,082,000	695,300
Pensions and other employee benefits	640,100	484,700
Other	463,400	409,000
Taxes other than income taxes	264,400	222,000
	<u>10,532,500</u>	<u>9,199,500</u>
	<u>6,002,200</u>	<u>5,034,700</u>
OTHER INCOME		
Allowance for funds used during construction (Note 1 (d))	91,300	115,000
Other	3,200	2,600
	<u>94,500</u>	<u>117,600</u>
	<u>6,096,700</u>	<u>5,152,300</u>
INTEREST		
Bond interest	1,702,700	1,591,300
Other (Note 2)	185,300	185,100
	<u>1,868,000</u>	<u>1,776,400</u>
	<u>4,228,700</u>	<u>3,375,900</u>
INCOME TAXES	<u>1,923,800</u>	<u>1,522,100</u>
NET INCOME	<u>2,304,900</u>	<u>1,853,800</u>
Preference Dividends	<u>483,000</u>	<u>450,700</u>
NET INCOME APPLICABLE TO COMMON SHARES	<u>1,821,900</u>	<u>1,403,100</u>
Earnings per common share	<u>1.90</u>	<u>1.74</u>

Retained Earnings Statement

For the year Ended December 31

	1978	1977
	\$	\$
RETAINED EARNINGS,		
beginning of year	3,524,700	3,128,800
ADDITIONS:		
Net income	2,304,900	1,853,800
DEDUCTIONS:		
Preference dividends	483,000	450,700
Common dividends	1,073,700	854,500
Commission and expenses of issuing capital stock and other deductions	1,400	152,700
	<u>1,558,100</u>	<u>1,457,900</u>
RETAINED EARNINGS, end of year	<u>4,271,500</u>	<u>3,524,700</u>

D.S. Inkpen
Comptroller

Statement of Sources of Funds Used for Construction

For the Year Ended December 31

	1978	1977
	\$	\$
SOURCE OF FUNDS:		
Internal—		
Operating revenues and other income	16,629,200	14,351,800
Less charges requiring working capital (Note 8)	<u>10,431,000</u>	<u>9,041,800</u>
Total internal - from Operations	<u>6,198,200</u>	<u>5,310,000</u>
External —		
Common stock	—	2,800,000
8 1/4 % Preference shares - 1977 series	—	1,200,000
First mortgage bonds	2,500,000	2,500,000
Bank and other notes	1,300,000	600,000
Employees' stock savings plan (Note 5)	128,100	95,200
Decrease in materials inventory	45,700	27,900
Decrease in working capital	—	59,600
Total external	<u>3,973,800</u>	<u>7,182,600</u>
Total source of funds	<u>10,172,000</u>	<u>12,492,600</u>
Funds used for other than construction—		
Redemption of Series D Bonds	500,000	—
Repayment of bank and other notes	500,000	2,475,000
Dividends	1,558,700	1,305,200
Other	137,000	128,400
Increase in working capital	<u>340,700</u>	<u>—</u>
Total funds used for other than construction	<u>3,034,400</u>	<u>3,908,600</u>
Total funds provided for construction	<u>7,137,600</u>	<u>8,584,000</u>
FUNDS USED FOR CONSTRUCTION:		
New telephone plant added	7,334,700	8,741,900
Cost of removing old plant	<u>135,100</u>	<u>141,000</u>
Construction program expenditures	<u>7,469,800</u>	<u>8,882,900</u>
Less charges not requiring working capital		
— Allowance for funds used during construction	91,300	115,000
— Salvage and Other	<u>240,900</u>	<u>183,900</u>
	<u>332,200</u>	<u>298,900</u>
Total funds used for construction	<u>7,137,600</u>	<u>8,584,000</u>

Notes to Financial Statements

1. Summary of significant accounting policies —

(a) System of accounts

The Company is subject to regulation, including examination of accounting practices, by the Public Utilities Commission for the Province of Prince Edward Island. The system of accounts and accounting practices are similar to those being used by other companies in the telecommunications industry.

(b) Accounting for telephone plant:

Telephone Plant is carried at cost.

Depreciation is charged on a straight-line basis using component rates for classes of plant, determined by a continuing program of engineering studies, as approved from time to time by the Public Utilities Commission for the Province of Prince Edward Island. These rates provide for depreciating the assets over their estimated service lives and resulted in a composite rate for 1978 of 5.8% (1977, 6.1%).

Materials inventory consists of items which will be used in the construction program.

(c) Income taxes:

Deferred tax accounting has been followed with respect to all timing differences.

(d) Allowance for funds used during construction:

The Company is allowed a return on capital invested in new telephone plant while under construction by including an "allowance for funds used during construction" as an addition to the cost of the plant constructed.

(e) During 1977 the Company made certain changes in the application of accounting principles to bring their accounting practices more in line with other industries. These revisions refer mainly to certain corporate overheads which are not readily identifiable with or do not vary directly with construction of telephone plant. These overheads which would have been capitalized and recovered through depreciation are now charged to operating expense.

The revisions were approved by the Public Utilities Commission of the Province of Prince Edward Island to be effective July 1, 1977, and resulted in an increased charge to expense of approximately \$50,700 for the period involved in 1977.

(f) Unamortized long-term debt expenses:

Unamortized long-term expenses are being amortized over the duration of the various debt issues.

2. Other interest — includes interest on bank and other notes of \$139,800 (1977, \$160,300) and amortization of long-term debt expenses amounting to \$17,500 (1977, \$16,400)

3. Other telephone plant — consists of land and telephone plant under construction.

4. Investments — includes investment, at cost, in miscellaneous physical property (\$51,300) and shares of Telesat Canada (\$60,000).

5. Capital Stock —

Authorized:

	1978	1977
	<u>\$20,000,000</u>	<u>\$20,000,000</u>
Shares Outstanding at Jan. 1, 1978	Shares Outstanding at Dec 31, 1978	
Issued:	Issued For Cash	
Common, par value \$5.00	957,609	11,531
Preference		
4 1/2 % par value \$10.00	40,000	40,000
4 1/4 % par value \$10.00	40,000	40,000
5 1/2 % par value \$20.00	37,500	37,500
7 1/4 % par value \$20.00	75,000	75,000
9 1/4 % par value \$20.00	100,000	100,000
9 1/4 % par value \$20.00 1977 Series	60,000	60,000
	<u>352,500</u>	<u>352,500</u>
TOTAL ISSUED	<u>1,310,109</u>	<u>11,531</u>
Value at par, of issued common and preference shares	<u>\$11,038,000</u>	<u>\$57,700</u>
		<u>\$11,095,700</u>

The Company reserved 13,000 common shares for issuance under the Employees' Stock Savings Plan and during the year issued 11,531 shares to employees under the terms and conditions of the Plan. These shares are generally issued in December of each year after the completion of twelve months of contributions at a purchase price equivalent to 80% of the average market price of the stock.

4 1/2 %, 4 1/4 %, and 5 1/2 % Preference Shares

These shares are non-voting unless eight quarterly dividends are in arrears. The Company may redeem the shares at any time, upon giving thirty days notice to the holders, at par plus a stated premium in each case and any accrued but unpaid dividends.

7 1/4 % Preference Shares

These shares are non-voting unless eight quarterly dividends are in arrears. The Company may redeem all or part of the outstanding shares at a premium of \$1.00 if redeemed before June 15, 1981, the premium thereafter decreasing \$0.20 every three years until June 15, 1990.

9 1/4 % Preference Shares

These shares are non-voting unless eight quarterly dividends are in arrears. The shares are not redeemable prior to June 15, 1979. After June 15, 1979 the Company may redeem all or part of the outstanding shares at a premium of \$1.45, the premium decreasing \$0.20 every three years until June 15, 1997.

9 1/4 % Preference Shares — 1977 Series

These shares are non-voting unless eight quarterly dividends are in arrears. The shares are not redeemable prior to April 15, 1982. After April 15, 1982 the Company may redeem all or part of the outstanding shares at a premium of \$1.45, the premium thereafter decreasing \$0.20 every three years until June 15, 1990.

6. Premium on common stock —

	1978	1977
	\$	\$
Beginning of year	3,852,400	2,012,300
On shares issued during year	70,200	1,840,100
End of year	<u>3,922,600</u>	<u>3,852,400</u>

7. Long-term debt —

(a) First mortgage bonds —

Series	Rate	Maturing	Principal
E	5 $\frac{1}{2}$ %	October 2, 1981	\$ 500,000
F	5 $\frac{1}{2}$ %	June 15, 1983	750,000
G	7 $\frac{3}{8}$ %	February 1, 1988	1,000,000
H	8 %	December 15, 1991	3,000,000
I	9 $\frac{1}{4}$ %	December 15, 1993	4,000,000
J*	11 %	January 15, 1995	3,500,000
K	11 %	March 31, 1996	2,500,000
L	10 $\frac{3}{8}$ %	June 1, 1997	2,500,000
M	10 $\frac{3}{8}$ %	December 1, 1998	2,500,000
			<u>\$20,250,000</u>

*The holders of Series J Bonds have the right to require the Company to repay the principal amount at par on January 15, 1985.

The First Mortgage Bonds are secured by a Deed of Trust and Mortgage and by deeds supplemental thereto containing a first and specific mortgage and charge upon the Company's land, buildings, plant and equipment and a first floating charge upon all other property, assets and rights of the Company, present and future, wheresoever situate.

(b) Bank and other notes — \$1,300,000

In order to permit the Company to time its new issues of debt or capital most advantageously the Company maintains a substantial bank line of credit and from time to time sells short-term promissory notes. Such short-term credit is replaced in the normal course by longer term financing and currently maturing debt issues are likewise normally refinanced. For this reason, the Company does not classify these items as current liabilities.

Likewise, the Company does not classify as current assets excess funds received through financing and temporarily invested in short-term investments.

8. Charges requiring working capital —

	1978	1977
	\$	\$
Operating expenses, interest and taxes	14,324,300	12,498,000
Less Charges not requiring an outlay of working capital during the period		
— Depreciation	2,971,400	2,752,000
— Deferred income taxes	955,500	771,000
— Other	57,700	48,200
	<u>3,984,600</u>	<u>3,571,200</u>
	10,339,700	8,926,800
Add credits not producing working capital		
— Allowance for funds used during construction	91,300	115,000
	<u>10,431,000</u>	<u>9,041,800</u>

9. Pension Fund —

Pension Fund Obligations are accounted for and paid over the estimated future working lifetime of employees of the Company. The contribution to the pension fund for the year ended December 31, 1978 amounted to \$703,300 (1977, \$542,300). The actuarial reviews as of December 31, 1976, based on earnings and service to that date, show that all vested benefits are fully funded.

10. Anti-inflation Act —

The Company is subject to the Anti-Inflation Act which provides authority for the imposition of Anti-Inflation restraints from October 14, 1975. The Act and the guidelines thereunder control profit margins, prices, dividends and compensation. The Anti-Inflation Act contains special provisions relating to the application of the guidelines to companies whose prices or profit margins are subject to approval by regulatory bodies. The Company is subject to regulation by the Public Utilities Commission of the Province of Prince Edward Island.

Section 4.1 (1) of the Anti-Inflation Act provides that any body that establishes or approves the prices or profit margins of any supplier to whom the guidelines apply shall, in exercising its powers, apply such guidelines as are applicable in the circumstances, modified to such extent, if any, as in the opinion of the body, is necessary to take into account the particular facts of the situation.

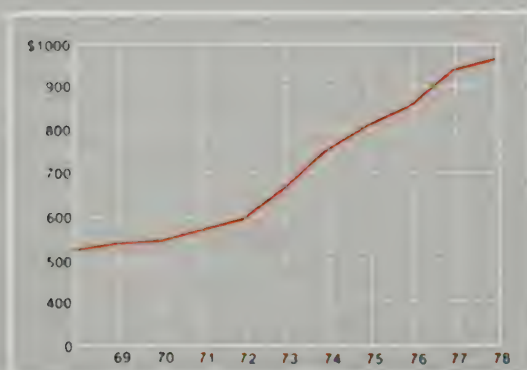
The restraints terminate December 31, 1978.

Management is satisfied that the Company has complied with the legislation and regulations thereunder.

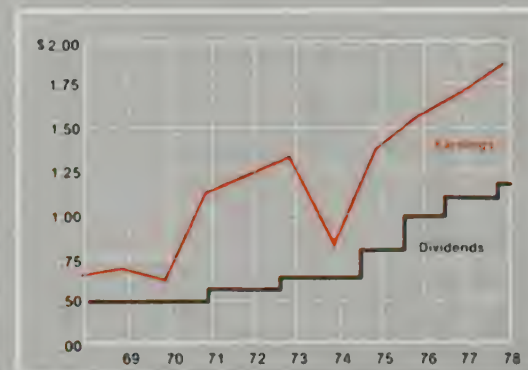
The Years in Review

	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
Financial Position at December 31 (in thousands)										
Telephone Plant	\$ 57,585	\$ 51,496	\$ 44,876	\$ 37,876	\$ 35,081	\$ 31,758	\$ 22,626	\$ 19,047	\$ 18,183	\$ 16,884
Accumulated depreciation	11,199	9,657	8,438	7,356	7,183	6,137	5,458	5,093	4,608	4,168
Investments	111	111	111	73	77	77	78	1,867	186	83
Current assets	2,546	1,026	1,200	1,975	1,346	1,208	755	614	520	514
Deferred charges	419	523	475	344	274	194	87	105	107	38
Shareholders' equity	19,290	18,315	18,924	15,717	15,295	21,273	8,778	6,492	6,331	6,481
Long term debt	21,550	18,750	13,175	17,790	12,723	11,275	7,175	8,600	5,660	3,110
Current liabilities	2,655	1,486	1,281	1,473	2,538	1,884	740	647	407	390
Deferred credits	5,967	3,033	4,201	3,473	2,977	2,488	1,812	1,576	1,764	1,784
Income (in thousands)										
Operating revenues	\$ 16,535	\$ 14,734	\$ 11,317	\$ 9,776	\$ 7,248	\$ 6,044	\$ 5,447	\$ 4,724	\$ 3,603	\$ 3,569
Operating expenses	10,533	9,200	8,340	6,467	5,385	4,203	3,471	2,717	2,190	2,080
Other income	95	118	80	238	87	70	21	15	5	10
Interest	1,868	1,775	1,485	1,482	617	415	291	430	400	313
Income taxes	1,924	1,529	1,110	886	684	679	472	644	403	451
Net income for year	2,305	1,854	1,248	1,183	732	671	602	700	412	450
Statistics — at December 31										
Telephone plant per telephone	\$ 969	\$ 928	\$ 887	\$ 897	\$ 965	\$ 908	\$ 883	\$ 909	\$ 934	\$ 923
Equity per common share	\$ 13.45	\$ 12.77	\$ 11.82	\$ 11.88	\$ 11.10	\$ 11.18	\$ 10.48	\$ 9.94	\$ 9.31	\$ 9.17
Embedded debt cost	9.6%	8.1%	6.2%	8.9%	8.1%	8.1%	8.8%	7.4%	7.1%	8.8
Long term debt % invested capital	52.8%	58.5%	58.7%	60.3%	53.7%	52.8%	44.8%	58.5%	47.7%	44.5%
Employees	293	291	288	279	267	264	264	255	271	268
Telephones in service	59,436	55,279	42,375	49,156	45,888	42,314	38,841	36,715	33,990	32,314
Dial telephones	100%	100%	94.6%	91.2%	87.4%	83.0%	78.7%	76.7%	73.0%	64.5%
Shareholders	3,334	2,285	2,876	2,928	2,851	2,180	2,180	1,791	1,188	1,512
Statistics — for year										
Earnings per common share	\$ 1.90	\$ 1.74	\$ 1.61	\$ 1.40	\$ 1.80	\$ 1.74	\$ 1.78	\$ 1.18	\$.83	\$.70
Average common shares	957,609	884,854	884,887	862,735	554,815	548,781	344,636	348,084	435,716	448,472
Dividends per common share	\$ 1.12	\$ 1.05	\$.91	\$.74	\$.65	\$.60	\$.60	\$.51	\$.59	\$.50
Times bond interest earned before taxes	3.6	3.7	3.0	3.7	7.3	6.3	4.3	5.0	5.7	6.5
Times bond interest earned after taxes	2.5	2.7	2.2	2.3	5.1	4.4	3.7	5.1	5.4	5.5
Return on average invested capital	10.9%	10.4%	9.8%	8.8%	7.5%	8.8%	8.8%	9.2%	9.7%	9.7%
Return on net debt	9.0%	8.4%	6.4%	6.1%	6.1%	7.7%	8.0%	7.0%	6.7%	5.7%
Return on average common equity	14.5%	14.1%	13.1%	11.4%	17.0%	15.3%	16.3%	16.0%	9.7%	7.0%
Construction program expenditures (in thousands)	\$ 7,470	\$ 6,481	\$ 6,314	\$ 7,181	\$ 6,447	\$ 6,438	\$ 3,700	\$ 2,474	\$ 1,953	\$ 1,885
Salaries and wages (in thousands)	\$ 4,580	\$ 4,120	\$ 3,774	\$ 2,888	\$ 1,895	\$ 1,810	\$ 1,664	\$ 1,374	\$ 1,088	\$.951
Average daily toll messages (in thousands)	13	17	11	10	8	8	8	7	6	6

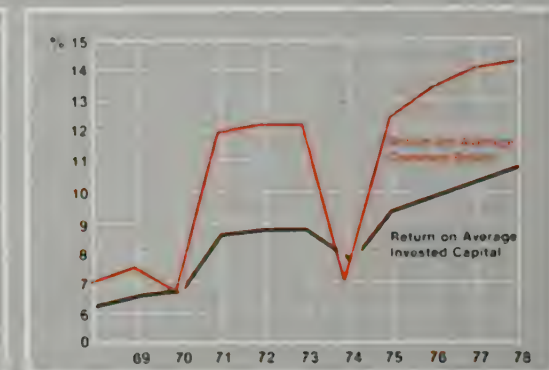
Telephone Plant per Telephone



Earnings and Dividends per Average Common Share



Rate of Return on Average Common Equity and Average Invested Capital



The Island Telephone Company, Limited

Incorporated under the laws of the Province of
Prince Edward Island
Head Office: 71 Belvedere Avenue, Charlottetown,
Prince Edward Island, Canada C1A 7M1
Telephone (Area Code 902) 894-5501

Registrar and Stock Transfer Offices

Canada Permanent Trust Company
129 Kent Street, Charlottetown, P.E.I. C1A 1N3
(Common shares, 4-½% Preference shares, 4-¾% Preference
shares, 5-½% Preference shares, 7-½% Preference shares,
9-¼% Preference shares, and 9-¼% (1977 series) Preference
shares)

600 Dorchester Boulevard, West, Montreal, Quebec H3B 1N6
(Common shares, 5-½% Preference shares, 7-¼% Preference
shares, 9-¼% Preference shares and 9-¼% (1977 series)
Preference shares

20 Eglinton Avenue, West, Toronto, Ontario M4R 2E2
(Common shares, 7-½% Preference shares, 9-¼% Preference
shares and 9-¼% (1977 series) Preference shares

315 Eighth Avenue, S.W. Calgary, Alberta T2P 1G8
(Common shares, 9-¾% Preference shares and 9-¼% (1977 series)
Preference shares

701 West Georgia Street, Vancouver, B.C. V7Y 1E5
(5-½% Preference shares)

1646 Barrington Street, Halifax, N.S. B3J 2P7
(Common shares, 5-½% Preference shares, 7-¼% Preference
shares, 9-¼% Preference shares and 9-¼% (1977 series)
Preference shares

Common Shares Listed
Montreal Stock Exchange
Toronto Stock Exchange

Valuation Day Prices
(December 22, 1971)

Common Shares	—\$10.25
4-½% Preference shares	—\$ 8.25
4-¾% Preference shares	—\$ 8.60
5-½% Preference shares	—\$15.25

The 1978 Annual Report is a summary of the operations of the
Company in its service to the people of Prince Edward Island. It
is prepared for those who have invested in the Company, for
those who are interested in the Company's performance and for
the employees.

A part of life

*You are rarely far from a telephone,
no matter where you go. Modern
telecommunications are an important
part of our everyday lives.*



The Island Telephone Company, Limited

Directors

- * **A. Gordon Archibald**
Chairman of the Board
Maritime Telegraph & Telephone Co., Ltd.
Halifax, N.S.
- * **Walter C. Auld**
Executive Vice President
The Island Telephone Company Limited
Charlottetown, P.E.I.
- * **Ivan E. H. Duvar**
Chairman of the Board & President
The Island Telephone Company Limited
Charlottetown, P.E.I.
- Charles J. Fraser**
President
Montague Drive-In Theatre Ltd.
Montague, P.E.I.
- * **Edward J. Hicks**
Vice President (Finance)
The Island Telephone Company Limited
Charlottetown, P.E.I.
- John J. Howatt**
President
Darlington Farms Ltd.
Darlington, P.E.I.
- William Herbert C. Leavitt**
President
The Leavitt's Maple Tree Craft
Alberton, P.E.I.
- * **Horace R. MacFarlane**
President
The Prince Edward Island
Bag Company, Limited
Summerside, P.E.I.
- * **Percy J. Smith**
Vice President
Great Eastern Corporation Ltd.
Halifax, N.S.

Officers

- Ivan E. H. Duvar**
Chairman of the Board
& President
- Walter C. Auld**
Executive Vice President
- Edward J. Hicks**
Vice President (Finance)
- Donald R. Livingstone**
General Manager
- David S. Inkpen**
Comptroller
- Donald B. Quinn**
Treasurer
- Stephen E. Jefferson**
Secretary
- James L. Cameron**
Assistant Secretary

Operations

- James L. Cameron**
General Administration Manager
- D. C. Barlow**
Staff Supervisor — Administration
- K.M. Frizzell**
Operator Services Manager
- S. L. Godfrey**
Plant Manager
- R. Livingstone**
Supervisor - Construction
- R. E. Meek**
Supervisor — Trunks & Switching
- D. C. Rogers**
Supervisor — Installation & Repair
- P. A. Trainor**
Engineering Supervisor —
Outside Plant
- A. E. Holland**
Commercial Manager
- D. W. McLane**
Marketing Manager

*Member Executive Committee

Island
Tel

AR16

Yisland

**Island
Tel**

File
The Island Telephone Company, Limited

interim report
second quarter 1978

condensed financial position statement

	As at June 30th	
	1978*	1977
	\$	\$
Telephone plant	54 474 454	49 175 008
Accumulated depreciation	10 607 184	9 141 902
Investments	111 332	111 332
Current assets	2 213 766	1 817 483
Deferred charges	435 599	371 740
Shareholders' equity — Preference	6 250 000	6 250 000
— Common	12 509 566	9 126 684
Long term debt	17 750 000	18 250 000
— First mortgage bonds	1 525 000	1 750 000
— Bank and other notes	3 013 986	2 280 148
Current liabilities	5 579 415	4 676 829
Deferred credits		

*Unaudited

interim income statement

	Three Months Ended June 30th		Six Months Ended June 30th	
	1978*	1977	1978*	1977
	\$	\$	\$	\$
Operating revenues	4 072 658	3 517 511	7 910 332	6 707 209
Operating expenses & other taxes (Notes 1 & 3)	2 626 348	2 295 470	5 040 504	4 311 061
	1 446 310	1 222 041	2 869 828	2 396 148
Other income	15 961	34 304	35 746	59 323
Income before interest and income taxes	1 462 271	1 256 345	2 905 574	2 455 471
Interest	446 956	444 312	887 037	870 374
	1 015 315	812 033	2 018 537	1 585 097
Income taxes (Note 2)	464 357	359 470	922 590	708 431
Net income	550 958	452 563	1 095 947	876 666
Dividends on preference shares	120 753	116 228	241 506	209 231
Net income applicable to common shares	430 205	336 335	854 441	667 435
Earnings per average common share	\$.45	\$.45	\$.89	\$.89
Average number of common shares outstanding	957 609	746 631	957 609	746 631
(Note 1) Includes depreciation of	\$ 736 816	\$ 660 875	\$ 1 511 104	\$ 1 303 168
(Note 2) Consists of:				
Income taxes payable	\$ 282 258	\$ 181 878	\$ 560 102	\$ 354 028
Income taxes deferred	\$ 182 099	\$ 177 592	\$ 362 488	\$ 354 403

(Note 3) The Company will apply in the year 1978 to the Prince Edward Island Public Utilities Commission for a revision to its depreciation rates; such rates to be effective January 1, 1978. The revised rates, if approved, will result in a decrease in depreciation expense of \$43,606 for the three months ended June 30, 1978 and \$85,826 for the six months ended June 30, 1978. Earnings per share will increase from \$0.45 to \$0.47 and from \$0.89 to \$0.94 respectively. Similarly, depreciation rates approved in December, 1977, effective January 1, 1977, resulted in an increase in depreciation expense of \$47,035 for the three months ended June 30, 1977 and \$93,766 for the six months June 30, 1977. Earnings per share decreased from \$0.48 to \$0.45 and from \$0.96 to \$0.89 respectively.

*Unaudited



A new look for Island Tel

Island Tel introduced a new corporate logo in June and it will be implemented throughout the coming year. Its first appearances were in advertising, but new letterhead and telephone bills will be appearing soon in the bright new corporate colors of orange, tan and white. Above: the new look for company vehicles is a safety-conscious choice — the colors were chosen for their superior visibility in traffic.

statement of sources of funds used for construction

	Six Months Ended June 30th	
	1978*	1977
	\$	\$
SOURCE OF FUNDS:		
Internal —		
Operating revenues and other income	7 946 078	6 766 532
Less charges requiring working capital	4 911 465	4 257 052
Total internal from operations	3 034 613	2 509 480
External —		
9 1/4% preference shares 1977 series	—	1 200 000
First mortgage bonds	—	2 500 000
Bank and other notes	1 525 000	1 750 000
Employees' stock savings plan	62 211	43 699
Decrease in materials inventory	1 991	—
Decrease in working capital	350 023	72 130
Total external	1 939 225	5 565 829
Total source of funds	4 973 838	8 075 309
Funds used for other than construction —		
Repayment of bank and other notes	500 000	2 475 000
Dividends	758 616	582 545
Increase in materials inventory	—	22 320
Other	64 794	106 865
Increase in working capital	500 000	—
Total funds used for other than construction	1 823 410	3 186 730
Total funds provided for construction	3 150 428	4 888 579
FUNDS USED FOR CONSTRUCTION:		
New telephone plant added	3 209 522	4 993 433
Cost of removing old plant	55 925	54 639
Construction program expenditures	3 265 447	5 048 072
Less charges not requiring working capital		
— Allowance for funds used during construction	34 689	64 740
— Salvage and other	80 330	94 753
	115 019	159 493
Total funds used for construction	3 150 428	4 888 579

*Unaudited



Safe Driving Award

Ed Garnhum, left, an exchange repairman in Charlottetown, has been driving for Island Tel for 20 years without an accident. Those 20 accident-free years represent 700,000 miles — equivalent to driving around the earth at the equator over 28 times without an accident! President Ivan Duvar, right, presented Mr. Garnhum with the golden President's Watch at the annual Awards Luncheon in Charlottetown May 30th. General Manager Don Livingstone also presented Mr. Garnhum with the National Safety Council's 20-Year Safe Driving Award Pin.

to the shareholders:

The 1977 Annual Meeting of the Company was held in Charlottetown on May 30, 1978. At the meeting, it was announced that the Company plans to spend \$33 million over the next five years for facilities and equipment required to meet forecasted growth in the telephone system. In addition, a further \$6 million will be spent during the same period for service improvements to the system.

Another highlight of the Annual Meeting was the announcement that over the next five years, the Company's Rural Line Reduction Program will reduce the number of subscribers on multi-party lines to a maximum of four customers on each multi-party line.

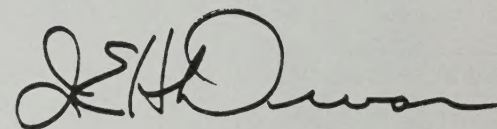
During the second quarter, the service improvement program continued with the introduction of Extended Area Service between four exchanges, affecting six different communities. The Extended Area Service Program provides for toll-free calling between Eldon and Charlottetown, Tyne Valley and Summerside, New London and Summerside, and Eldon and Vernon River. Total cost of equipment and buildings to implement this program was \$480,000; more than 35,000 subscribers will directly benefit from this service improvement.

The Board of Directors has approved adoption of a new corporate symbol for all Company vehicles, signs, stationery, etc. (see photograph inside and cover design). The corporate symbol, featuring the phrase 'Island Tel' and a stylized telephone, was designed to increase Company visibility to subscribers in all areas of the Province. Vehicle safety and easy identification of Company employees and property were important considerations in the design of this symbol. Implementation of the "new look" has commenced and the program will be fully implemented throughout the Company within a year.

Look for company vehicles is a safety-conscious choice -- the colors were chosen for their superior visibility in traffic.

1978 is proving to be a year of solid growth in the provincial telephone network. During the first half of this year, there has been a net increase of 1,880 telephones in service. This represents an increase of 49.1% over the gain in telephones during the first six months of 1977. The number of long distance calls also continues to grow at a strong rate. Long distance revenues were 19.2% higher during the first half of 1978 than the corresponding period in 1977.

Earnings per average common share to date are \$.89. This compares to \$.89 for the same period a year ago (see note on depreciation on Interim Income Statement inside). The rate of return to date on average common equity is 13.8% compared to 14.8% a year ago, and the return on average invested capital is 10.6% compared to 10.4%.



I. E. H. Duvar
Chairman of the Board
and President

Charlottetown, P.E.I.
August 1, 1978

Drawing Award Pin.